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Supreme Court of the United States

OCTOBER TERM, 1954.

No. 214.

INDUSTRIAL COMMISSIONER OF THE STATE OF NEW YORK,

Petitioner,

against

SWORD LINE, INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF OF RESPONDENT IN OPPOSITION.

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Opinions Below.

The opinions below are given in the petition. The opinion of the Court of Appeals is now reported in 212 F. 2d 865 (1954).

Jurisdiction.

The jurisdictional requirements are adequately set forth in the Petition.

Question Presented.

The first of the two questions stated by petitioner is concerning the jurisdiction of the Court of Appeals to rule on the existence of post-arrangement interest. We suggest this is incorrectly stated. The question, if any, would seem to be the jurisdiction of the Referee in Bankruptcy.

Statutes Involved.

Additional pertinent provisions of the Bankruptcy Act are set forth herein where they are mentioned.

Statement.

We add the following to petitioner's statement.

The issue of the existence of post-arrangement interest was pending before the Referee by objection taken to the State's proof of claim and answer to such objection filed by the State (R. 1-2). By order of the Court dated July 30, 1948, the State had been enjoined from commencing any action against the Debtor in the State Court (R. 4). The State was fully cognizant of this order (R. 7). The State, while said issue was pending before the Referee (R. 5), *ex parte* without leave of Court purported to file an amended claim deleting post-arrangement interest and also entered *ex parte* a judgment for such interest in the State Court (R. 6).

The Debtor then brought on said original issue to be heard on July 2, 1952. At the same time the Debtor made a separate motion to have determined that under the Bankruptcy Act interest stopped for all purposes upon the filing of the petition in the case at bar regardless of where it was sought to be collected. This motion was also set down to be heard on said July 2, 1952. As incidental relief under the second motion, the Debtor requested an order directing the expunging of the State Court judgment and for a permanent injunction (R. 19).

The Referee decided from the bench on July 2, 1952 that no interest would run in the case at bar after the filing of Debtor's petition. Orders granting relief requested were to be settled on notice (R. 2). The interest involved amounted to something over $30,000 (R. 18).

On July 31, 1952 (29 days later) the Amended Plan of Arrangement was presented to creditors and the Referee for their approval. The Plan provided for payment *without interest* of unsecured claims as follows: 40% of claims over $5,000; 50% of claims between $5,000 and $1,000 and 60% of claims for less than $1,000. It also provided for payment in full *without interest* on a deferred installment basis to creditors electing to receive such payments over a five year period. The Plan was accepted by creditors and the Referee confirmed it by order entered the same day (R. 2).

The inability of the Debtor to pay its debts in full was not questioned below and the petitioner conceded the Debtor's insolvency at the time of filing the petition.

Argument.

The petitioner presents two questions which it claims warrant the consideration of this Court. The first is:

I.

> "(1) Whether, under the facts and circumstances of this case, the Court of Appeals was correct in its ruling that it had jurisdiction to determine the liability of the debtor for post-arrangement interest after the confirmation of the arrangement and close of the proceeding."

The Court of Appeals reversed the order of the District Court (R. 38) thereby reinstating the ruling of the Referee that petitioner was "not entitled to interest on its claim against the Debtor beyond the date of the filing of the Debtor's petition herein whether said claim be made before this Court or any other forum" (R. 7). No objection was raised below as to the jurisdiction of the Court of Appeals

to entertain the appeal taken to it by the Debtor. We take it then that the question put is intended to question the jurisdiction of the Referee in making his determination.

The Referee decided a necessary question basic to all Chapter XI proceedings. Under Section 366 of the Bankruptcy Act[1] the Court (including by definition the Referee[2]) shall confirm an arrangement if satisfied that it is "for the best interests of the creditors" and it is "fair and equitable and feasible". In order to determine whether these conditions are met, the Debtor's assets and liabilities must be known. Necessary to the ascertainment of liabilities was the Referee's decision as to whether post-arrangement interest existed. If the interest existed, then secondary problems such as the time when it would become payable would, of course, be pertinent, but first the basic issue of its existence had to be determined. It was also necessary from the point of view of creditors to have this liability determined, particularly in the case of creditors considering the relative advantages of taking cash or deferred payments over a five year period.

Petitioner, in his argument (pp. 15-17) on this question, ignores the fact that the Debtor brought on a separate motion to have this issue determined by the Referee and that it regularly came on to be heard and decided by the Referee. The issue was also presented on the original

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[1] Section 366 provides:

"The court shall confirm an arrangement if satisfied that * * * (2) it is for the best interests of the creditors; (3) it is fair and equitable and feasible; * * *"

[2] Section 1 provides:

"The words and phrases used in this Act and in proceedings pursuant hereto shall, unless the same be inconsistent with the context, be construed as follows: * * * (9) 'Court' shall mean the judge or the referee of the Court of Bankruptcy in which the proceedings are pending."

objection to petitioner's proof of claim. Petitioner's argument is that the amendment to the proof of claim filed *ex parte* removes the issue from the jurisdiction of the Referee. The amended proof of claim certainly had no bearing on the separate motion brought by the Debtor and, furthermore, petitioner overlooks that since the 1938 Bankruptcy Act such issue can only be withdrawn by leave of the Court.*

Although not stated as a question, petitioner also argues (pp. 13-15) that the exercise by the Referee of discretion to grant a permanent injunction warrants review by this Court in that it is in conflict with the decision of this Court in *Local Loan Co.* v. *Hunt*, 292 U. S. 234 (1934). The fact is that in the *Hunt* case, this Court affirmed the decision granting such an injunction. We submit the circumstances in the case at bar were sufficiently unusual to authorize the Referee in his discretion to issue the injunction under the very criteria laid down in the *Hunt* case. *Cf. Ciavarella* v. *Salituri*, 153 F. 2d 343 (C. A. 2nd 1936); *Greenfield* v. *Tuccillo*, 129 F. 2d 854 (C. A. 2nd 1942).

In no event, however, are any of the points above discussed of sufficient importance to require the attention of this Court. It might be noted that the dissenting judge below did not even mention them.

II.

The second question stated by petitioner is:

> "(2) Whether the Court of Appeals erred on the law in concluding that such interest did not arise during the course of the arrangement proceeding and

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* Federal Rules of Civil Procedure, Rule 41(a); *Matter of Empire Coal Sales Corp.*, 45 F. Supp. 974 (S. D. N. Y. 1942), aff'd *sub nom. Kleid* v. *Ruthbell Coal Co.*, 131 F. 2d 372 (C. C. A. 2d 1942). See 3 Collier on Bankruptcy (14th Ed.) 657.12, pp. 177-180.

that the debtor will not be liable therefor after the confirmation of the arrangement and close of the proceeding."

A.

The State first argues that the ruling of the Court of Appeals on this question "is in conflict with applicable decisions of this Court" (p. 7). We submit this contention is incorrect.

The whole subject of interest on tax claims was considered by this Court in *City of New York* v. *Saper*, 336 U. S. 328 (1949). The issue was stated to be: "The ultimate issue in these three cases is whether tax claims against a bankrupt bear interest until the date of bankruptcy, as held by the court below, or until payment, as previously held by another Court of Appeals" (p. 329).

The Court then continued "More than forty years ago, Mr. Justice Holmes wrote for this Court that the rule stopping interest at bankruptcy had then been followed for more than a century and a half. He said the rule was not a matter of legislative command or statutory construction but, rather, a fundamental principle of the English bankruptcy system which we copied." (p. 330). After considering the changes made in the Bankruptcy Act since the earlier decisions, this Court concluded: "The Court of Appeals concluded that by the 1926 amendment and the Chandler Act, Congress assimilated taxes to other debts for all purposes, including denial of post-bankruptcy interest. We think this is a sound and logical interpretation of the Act after those amendments * * *. Considered in conjunction with the general rule against post-bankruptcy interest * * * they compel our conclusion, already stated, that the statute as amended did not contemplate any exception in favor of tax claims." (pp. 337-338)

The applicability of this rule to a Chapter XI proceeding, to a Chapter X proceeding, and to a general assignment for benefit of creditors was thereafter affirmed by this Court without opinion. *United States* v. *General Engineering & Manufacturing Co.*, 342 U. S. 912 (1952) [Chapter XI proceeding]; *United States* v. *Edens*, 342 U. S. 912 (1952) [Chapter X Proceeding]; *United States* v. *Bloom*, 342 U. S. 912 (1952) [New York Debtor and Creditor Law].

The distinction which petitioner would make of the *Saper* and *General Engineering* cases (although not made in the cases themselves) is that post-petition interest would not be provable in a straight bankruptcy proceeding (*Saper* case) or in a Chapter XI proceeding (*General Engineering* case) and therefore this Court did not necessarily by these cases outlaw post-petition interest for all time. Even if this were true, it hardly establishes the contention (p. 9) that "the bankruptcy rule merely suspends or postpones the accrual of interest during bankruptcy". Furthermore, the language certainly in the *Saper* case is contrary to this view.

The *Edens* case (Chapter X proceeding) is not mentioned in petitioner's brief and would seem inconsistent with petitioner's position. Under the provisions of Section 106 of the Bankruptcy Act* post-petition interest was provable in the Chapter X proceeding if it existed. Post-petition interest, however, was denied also in that case.

Furthermore, the general law applicable to interest is not that stated by the petitioner. The general rule is that, in the absence of a statutory provision, interest stops on

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*Section 106(1) provides:

"(1) 'claims' shall include all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under section 63 of this Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent;"

all claims at the date of the beginning of the bankruptcy proceeding. *Sexton* v. *Dreyfus*, 219 U. S. 339 (1911). The rule is repeated in *Vanston Committee* v. *Green*, 329 U. S. 156 (1946):

> "The general rule in bankruptcy and in equity receivership has been that interest on the debtors' obligations ceases to accrue at the beginning of proceedings. Exaction of interest, where the power of a debtor to pay even his contractual obligations is suspended by law, has been prohibited because it was considered in the nature of a penalty imposed because of delay in prompt payment—a delay necessitated by law if the courts are properly to preserve and protect the estate for the benefit of all interests involved" (p. 163).

The right of petitioner to be treated differently from other creditors arises, if at all, from Section 64 of the Bankruptcy Act.* Section 64 merely states that taxes legally due a State are entitled to priority. Nothing is said in Section 64 or indeed anywhere else in the Bankruptcy Act about interest on taxes. This Court, in the *Saper* and successor cases, rejected the inclusion of interest under Section 64 in bankruptcy proceedings. Not to claim, however, a statutory position puts the State on the same level of creditors governed by the general rule as set forth above in *Vanston Committee* v. *Green*. What the State requests, as we view it, is to have this Court take this case in order to

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* The applicable portion of this Section provides:

> "(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be * * * (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof * * * and *provided further*, that, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court;"

create a special classification which, on the one hand, does not come within Section 64 and yet, on the other hand, is not governed by the rule applicable when Section 64 does not apply. The State points to no statutory or judicial authority for this extraordinary result.

The cases which petitioner presents as representing the rule that interest continues to run in a bankruptcy proceeding are those in which the creditor holds security worth an amount in excess of the principal of the debt or where such security produces interest or dividends during bankruptcy and he could also urge the situation where the debtor becomes solvent. These may or may not be, today, exceptions to the general rule but, in any event, they are not even argued to be the situation in the case at bar.

The opinion of the dissenting judge below rests on the premise that interest did not stop when the bankruptcy proceeding was begun. He therefore treats the question in terms of its discharge and thereby reaches the conclusion there is a "serious defect in Chapter XI" (R. 31). But if no interest arose, then the alleged "defect" in the discharge provisions of the Bankruptcy Act is illusory. Birth is a condition precedent to death.

We submit, therefore, that petitioner's contention that the decision below is in conflict with applicable decisions of this Court is without merit.

B.

The State next argues (p. 11) that the decision of the Court below is in direct conflict with New York State court decisions. The State cites as its authority for this proposition *Matter of Paley* (*Ritholtz*), 285 N. Y. 641 (1941), aff'g 260 App. Div. 632. The pertinent issue in this case was whether or not a judgment in the State Court properly included post-bankruptcy interest. The Court's

position was that debtors "who voluntarily permit[ted] the continuance of the litigation in the State court in the hope of defeating the claim there and getting a judgment for themselves for costs against the claimant" (260 App. Div. at 636) fall under special sections of the Bankruptcy Act there quoted applicable to this special situation.

The Court expressly recognized the normal rule to be "It is true that where, as here, the assets of the estate in bankruptcy are less than the liabilities, interest stops on unsecured debts at the time of filing the petition * * *. The cessation of interest on unsecured debts, where the assets are not sufficient to pay the claims in full, refers only to interest accruing against the estate in bankruptcy; it does not refer to interest that has ripened into a right against the bankrupt himself after the petition and before the discharge, by reason of the bankrupt's election to continue to litigate his liability in another forum." (260 App. Div. at p. 636).

This case is obviously not authority for the proposition for which it is cited aside from the fact it was decided some years before the law was clarified in the *Saper* case.

On the other hand, the very tax here involved was considered after the *Saper* case by the Court of Appeals of the State of New York in *Matter of Pavone Textile Corp.*, 302 N. Y. 206 (1951), aff'd *sub nom. United States* v. *Bloom*, 342 U. S. 912 (1952). The question presented was whether or not interest stopped upon an assignment for benefit of creditors under the New York Debtor and Creditor Law. The Appellate Division for the First Department recognized that this Court denied interest on tax claims in bankruptcy proceedings but stated that the contrary rule was provided by the applicable State statute in State insolvency proceedings. The Court of Appeals, however, reversed the Appellate Division and necessarily decided that, as a matter

of statutory construction of the New York statute there involved and here involved, that no interest arose after the filing of a petition.

Thus, we submit, the New York State Court decisions are directly contrary to that urged by petitioner.

C.

The final argument (p. 13) of petitioner under this point is based on the premise that penalties survive bankruptcy. There are separate principles obviously here involved and we cannot see the relevancy of such an argument.

Conclusion.

We therefore submit there is no reason why this Court should grant the writ requested in the case at bar. The decision below is not in conflict with the decisions of this Court or of the New York State courts. It is consistent with the language of these decisions and we think it is compelled by the decision in the *Edens* case. The result requested would vitiate the principle stated in the *Saper* and successor cases. The execption so created to the general rule would in turn create "a serious defect in Chapter XI".

If, nevertheless, this Court wished to consider this question further, we suggest it should wait until there was some diversity in the Courts below on this point, if this should ever occur, and at such time take the matter up for review.

Respectfully submitted,

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